

(iv) For plan years beginning before January 1, 1987, or such later date provided in paragraph (h) of this section, the matching contributions, excluding those qualified matching contributions treated as elective contributions for purposes of the actual deferral percentage test, satisfy the requirements of section 401(a)(4).

(v) The qualified nonelective contributions and qualified matching contributions satisfy the requirements of paragraph (b)(4)(i)(A) of this section for the plan year as if the contributions were elective contributions.

(vi) For plan years beginning after December 31, 1988, or such later date provided in paragraph (h) of this section, the section 401(k) plan and the plan or plans to which the qualified nonelective contributions and qualified matching contributions are made, could be aggregated under § 1.410(b)-7(d) after application of the mandatory disaggregation rules of § 1.410(b)-7(c), as modified in § 1.401(k)-1(g)(11). If the plan year of the section 401(k) plan is changed to satisfy the requirement under § 1.410(b)-7(d)(5) that aggregated plans have the same plan year, the qualified nonelective contributions and qualified matching contributions may be taken into account in the resulting short plan year only if the contributions satisfy the requirements of paragraph (b)(4)(i) of this section with respect to the short year as if the contributions were elective contributions and the aggregated plans could otherwise be aggregated for purposes of section 410(b).

(6) *Examples.* The provisions of this paragraph (b) are illustrated by the following examples.

Example 1. (i) Employees A, B, and C are eligible employees who earn \$30,000, \$15,000, and \$10,000, respectively, in 1989. In addition, their employer, X, contributes a bonus of up to 10 percent of their regular compensation to a trust under a profit-sharing plan that includes a cash or deferred arrangement. Under the arrangement, each eligible employee may elect to receive none, all, or any part of the 10 percent in cash. The employer contributes the remainder to the trust. The cash portion of the bonus, if any, is paid after the end of the plan year. The 10 percent is therefore not included in compensation until the year paid. Employee A is highly compensated. For the 1989 plan year, A, B, and C make the following elections:

Employee	Compensation	Elective contribution
A	\$30,000	\$1,780
B	15,000	750
C	10,000	450

(ii) The ratios of employer contributions to the trust on behalf of each eligible employee to the employee's compensation for the plan year (calculated separately for each employee) are:

Employee	Ratio of elective contribution to compensation	Actual deferral ratio (percent)
A	\$1,780/\$30,000	5.93
B	750/\$15,000	5.00
C	450/\$10,000	4.50

(iii) The actual deferral percentage for the highly compensated group (Employee A) is 5.93 percent. The actual deferral percentage for the nonhighly compensated group is 4.75 percent $((5\%+4.5\%)/2)$. Because 5.93 percent is less than 5.94 percent $(4.75\% \text{ multiplied by } 1.25)$, the first percentage test is satisfied.

Example 2. (i) The facts are the same as in *Example 1*, except that elective contributions are made pursuant to a salary reduction agreement and no bonuses are paid. Employer X includes elective contributions in compensation as permitted under § 1.414(s)-1(c)(4)(i). See § 1.401(k)-1(g)(2)(i). In addition, A defers \$2,025. Thus, the compensation and elective contributions for A, B, and C are:

Employee	Compensation	Elective contributions	Actual deferral ratio (percent)
A	\$30,000	\$2,025	6.75
B	15,000	750	5.00
C	10,000	450	4.50

(ii) The actual deferral percentage for the highly compensated group (Employee A) is 6.75 percent. The actual deferral percentage for the nonhighly compensated group is 4.75 percent $((5.00\%+4.50\%)/2)$. Because 6.75 percent exceeds 5.94 percent $(4.75\% \times 1.25)$, the first percentage test is not satisfied. However, since the actual deferral percentage equals the maximum percentage allowed under the second percentage test, $(4.75+2=6.75)$, the second percentage test is satisfied.

Example 3. (i) Employees D through L are eligible employees in Employer A's profit-sharing plan that contains a cash or deferred arrangement. Employer A includes elective contributions in compensation as permitted under § 1.414(s)-1(c)(4)(i). Each eligible employee may elect to defer up to six percent of compensation under the cash or deferred arrangement. Employees D and E are highly compensated. The compensation, elective contributions, and actual deferral ratios of these employees for the 1989 plan year are shown below:

§ 1.401(k)-1

26 CFR Ch. I (4-1-97 Edition)

Employee	Compensation	Elective contributions	Actual deferral ratio (percent)
D	\$100,000	\$6,000	6
E	80,000	4,000	5
F	60,000	3,600	6
G	40,000	1,600	4
H	30,000	1,200	4
I	20,000	600	3
J	20,000	600	3
K	10,000	300	3
L	5,000	150	3

(ii) The actual deferral percentage for the highly compensated group is 5.5 percent. The actual deferral percentage for the nonhighly compensated group is 3.71 percent. Because 5.5 percent is greater than 4.64 percent ($3.71\% \times 1.25$), the first percentage test is not satisfied. However, because 5.5 percent is less than 5.71 percent (the lesser of $3.71\% + 2$ or $3.71\% \times 2$), the second percentage test is satisfied.

Example 4. (i) Employer D maintains a profit-sharing plan that contains a cash or deferred arrangement. Employer D includes elective contributions in compensation as permitted under § 1.414(s)-1(c)(4)(i). The following amounts are contributed under the plan:

(A) Six percent of each employee's compensation. These contributions are not qualified nonelective contributions (QNCs).

(B) Two percent of each employee's compensation. These contributions are QNCs.

(C) Three percent of each employee's compensation that the employee may elect to receive as cash or to defer under the plan.

(ii) For the 1990 plan year, the compensation, elective contributions, and actual deferral ratios of employees M through S were:

Employee	Compensation	Elective contributions	Actual deferral ratio (percent)
M	\$100,000	\$3,000	3
N	80,000	1,600	2
O	60,000	1,800	3
P	40,000	0	0
Q	30,000	0	0
R	20,000	0	0
S	20,000	0	0

(iii) Both types of nonelective contributions are made for all employees. Thus, both the six percent and the two percent employer contributions satisfy the requirements of section 401(a)(4) and paragraph (b)(5)(i) of this section.

(iv) The elective contributions alone do not satisfy the special rules in paragraph (b)(4) of this section because the actual deferral percentage for the highly compensated group, consisting of employees M and N, is 2.5 percent and the actual deferral percentage for the nonhighly compensated group is 0.6 percent. However, the two percent QNCs may be taken into account in applying the

special rules. The six percent nonelective contributions may not be taken into account because they are not QNCs.

(v) If the two percent QNCs are taken into account, the actual deferral percentage for the highly compensated group is 4.5 percent, and the actual deferral percentage for the nonhighly compensated group is 2.6 percent. Because 4.5 percent is not more than two percentage points greater than 2.6 percent, and not more than two times 2.6, the actual deferral percentage test of section 401(k)(3) and paragraph (b)(2) of this section is satisfied. Thus, the plan satisfies this paragraph (b).

Example 5. (i) Employer N maintains a plan that contains a cash or deferred arrangement. The plan year and the employer's taxable year are the calendar year. The plan provides for employee contributions, elective contributions, matching contributions, and qualified nonelective contributions (QNCs), all of which meet the applicable requirements of section 401(a)(4). Matching contributions on behalf of nonhighly compensated employees are qualified matching contributions (QMACs). Matching contributions on behalf of highly compensated employees are not QMACs. For the 1988 plan year, elective contributions and matching contributions with respect to highly compensated and nonhighly compensated employees are shown in the following chart.

	Elective contributions (including QNCs) (percent)	Total matching contributions (percent)	QMACs (percent)
Highly compensated	15	5	0
Nonhighly compensated ...	11	5	5

(ii) The plan fails to meet the requirements of section 401(k)(3)(A) because 15 percent is more than 125 percent of, and more than two percentage points greater than, 11 percent. However, the plan provides that QMACs may be used to meet the requirements of section 401(k)(3)(A)(ii) to the extent needed under that section. Under this provision, the plan takes QMACs of one percent of compensation into account for each nonhighly compensated employee in applying the actual deferral percentage test. After this adjustment, the actual deferral and actual contribution percentages are as follows:

	Actual deferral percentage	Actual contribution percentage
Highly compensated	15	5
Nonhighly compensated	12	4

(iii) The elective contributions and QMACs taken into account under section 401(k) meet the requirements of section 401(k)(3)(A)(ii)

because 15 percent is 125 percent of 12 percent. The remaining matching contributions meet the requirements of section 401(m) because five percent is 125 percent of four percent.

(c) *Nonforfeatability requirement*—(1) *General rule.* A cash or deferred arrangement satisfies this paragraph (c) only if the elective contributions meet each of the following requirements:

(i) Each employee's right to the amount attributable to elective contributions is immediately nonforfeitable within the meaning of section 411, and would be nonforfeitable under the plan regardless of the age and service of the employee or whether the employee is employed on a specific date. A contribution that is subject to forfeitures or suspensions permitted by section 411(a)(3) does not satisfy the requirements of this paragraph (c).

(ii) The contributions are disregarded for purposes of applying section 411(a) to other contributions or benefits.

(iii) The contributions remain nonforfeitable even if the employee makes no additional elective contributions under a cash or deferred arrangement.

(2) *Example.* The provisions of this paragraph (c) are illustrated by the following example:

Example. (i) Employees B and C are covered by Employer Y's stock bonus plan, which includes a cash or deferred arrangement. Under the plan, Employer Y makes a nonelective contribution on behalf of each employee equal to four percent of compensation. All employees participating in the plan have a nonforfeitable right to a percentage of their accrued benefit derived from this contribution as shown in the following table:

Years of service	Nonforfeitable percentage
Less than 1	0
1	20
2	40
3	60
4	80
5 or more	100

(ii) B and C have three and six years of service, respectively. Employer Y also permits employees to elect to defer up to 6 percent of compensation through salary reduction agreements. Amounts deferred under these agreements are nonforfeitable at all times. In accordance with paragraph (c)(1)(i) of this section, the nonforfeitable percentage of Employer Y's nonelective contribution on behalf of B and C may not be treated as a qualified nonelective contribution under

paragraph (b)(3) of this section, because these amounts are nonforfeitable by reason of the completion by B and C of a stated number of years of service, and not regardless of the age and service of B and C.

(d) *Distribution limitation*—(1) *General rule.* A cash or deferred arrangement satisfies this paragraph (d) only if amounts attributable to elective contributions may not be distributed before one of the following events, and any distributions so permitted also satisfy the requirements of paragraphs (d) (2) through (6) of this section (to the extent applicable):

(i) The employee's retirement, death, disability, or separation from service.

(ii) In the case of a profit-sharing or stock bonus plan, the employee's attainment of age 59½, or the employee's hardship.

(iii) For plan years beginning after December 31, 1984, the termination of the plan.

(iv) For plan years beginning after December 31, 1984, the date of the sale or other disposition by a corporation of substantially all the assets (within the meaning of section 409(d)(2)) used by the corporation in a trade or business of the corporation to an unrelated corporation.

(v) For plan years beginning after December 31, 1984, the date of the sale or other disposition by a corporation of its interest in a subsidiary (within the meaning of section 409(d)(3)) to an unrelated entity or individual.

(2) *Rules applicable to hardship distributions*—(i) *Distribution must be on account of hardship.* A distribution is treated as made after an employee's hardship for purposes of paragraph (d)(1)(ii) of this section only if it is made on account of the hardship. For purposes of this rule, a distribution is made on account of hardship only if the distribution both is made on account of an immediate and heavy financial need of the employee and is necessary to satisfy the financial need. The determination of the existence of an immediate and heavy financial need and of the amount necessary to meet the need must be made in accordance with nondiscriminatory and objective standards set forth in the plan. See section 411(d)(6) and the regulations thereunder.